

PDL BIOPHARMA, INC.
Form 10-Q
April 28, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2011

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For transition period from _____ to _____

Commission File Number: 000-19756

PDL BIOPHARMA, INC.
(Exact name of registrant as specified in its charter)

Delaware 94-3023969
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification Number)
organization)

932 Southwood Boulevard
Incline Village, Nevada 89451
(Address of principal executive offices and Zip Code)

(775) 832-8500
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Edgar Filing: PDL BIOPHARMA, INC. - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes No

As of April 25, 2011, there were 139,679,752 shares of the Registrant's Common Stock outstanding.

Index

PDL BIOPHARMA, INC.

INDEX

	Page
PART I - FINANCIAL INFORMATION	
ITEM 1.	3
<u>FINANCIAL STATEMENTS</u>	
<u>Condensed Consolidated Statements of Income for the Three Months Ended March 31, 2011 and 2010</u>	3
<u>Condensed Consolidated Balance Sheets at March 31, 2011 and December 31, 2010</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2011 and 2010</u>	5
<u>Notes to the Condensed Consolidated Financial Statements</u>	6
ITEM 2.	13
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	
ITEM 3.	22
<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	
ITEM 4.	23
<u>CONTROLS AND PROCEDURES</u>	
PART II - OTHER INFORMATION	
ITEM 1.	24
<u>LEGAL PROCEEDINGS</u>	
ITEM 1A.	26
<u>RISK FACTORS</u>	
ITEM 6.	27
<u>EXHIBITS</u>	
<u>SIGNATURES</u>	28

We own or have rights to certain trademarks, trade names, copyrights and other intellectual property used in our business, including PDL BioPharma and the PDL logo, each of which is considered a trademark. All other company names, product names, trade names and trademarks included in this Quarterly Report are trademarks, registered trademarks or trade names of their respective owners.

Index

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PDL BIOPHARMA, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited)
 (In thousands, except per share amounts)

	Three Months Ended March 31,	
	2011	2010
Revenues:		
Royalties	\$73,336	\$62,061
License and other	10,000	-
Total revenues	83,336	62,061
General and administrative expenses	5,779	9,410
Operating income	77,557	52,651
Interest and other income, net	175	80
Interest expense	(9,154)	(12,527)
Income before income taxes	68,578	40,204
Income tax expense	24,033	14,197
Net income	\$44,545	\$26,007
Net income per basic share	\$0.32	\$0.22
Net income per diluted share	\$0.25	\$0.15
Cash dividends declared per common share	\$0.60	\$1.00
Shares used to compute net income per basic and diluted share:		
Shares used to compute net income per basic share	139,640	119,525
Shares used to compute net income per diluted share	184,954	184,308

See accompanying notes.

Index

PDL BIOPHARMA, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (In thousands, except per share amounts)

	March 31, 2011 (unaudited)	December 31, 2010 (Note 1)
Assets		
Current assets:		
Cash and cash equivalents	\$126,713	\$ 211,574
Short-term investments	33,685	34,658
Receivables from licensees	150	469
Deferred tax assets	17,057	19,902
Foreign currency hedge	-	5,946
Prepaid and other current assets	7,787	12,114
Total current assets	185,392	284,663
Property and equipment, net	65	80
Long-term investments	33,065	1,997
Long-term deferred tax assets	24,595	22,620
Other assets	5,587	7,306
Total assets	\$248,704	\$ 316,666
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$286	\$ 2,540
Accrued legal settlement	27,500	65,000
Accrued liabilities	3,456	5,471
Deferred revenue	1,713	1,713
Dividend payable	62,862	20
Current portion of convertible notes payable	133,464	-
Current portion of non-recourse notes payable	117,677	119,247
Total current liabilities	346,958	193,991
Convertible notes payable	177,137	310,428
Non-recourse notes payable	66,282	85,023
Other long-term liabilities	29,531	51,406
Total liabilities	619,908	640,848
Commitments and contingencies (Note 13)		
Stockholders' deficit:		
Preferred stock, par value \$0.01 per share, 10,000 shares authorized; no shares issued and outstanding	-	-
Common stock, par value \$0.01 per share, 250,000 shares authorized; 139,640 issued and outstanding at March 31, 2011 and December 31, 2010	1,396	1,396
Additional paid-in capital	(171,131)	(87,373)
Accumulated other comprehensive income	(4,590)	3,219
Accumulated deficit	(196,879)	(241,424)
Total stockholders' deficit	(371,204)	(324,182)
Total liabilities and stockholders' deficit	\$248,704	\$ 316,666

See accompanying notes.

4

Index

PDL BIOPHARMA, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)
 (In thousands)

	Three Months Ended March 31, 2011	
	2011	2010
Cash flows from operating activities		
Net income	\$44,545	\$26,007
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of convertible notes offering costs	578	501
Amortization of non-recourse notes offering costs	1,466	1,881
Other amortization and depreciation expense	313	34
Stock-based compensation expense	50	188
Tax benefit from stock-based compensation arrangements	-	1,989
Net excess tax benefit from stock-based compensation	-	(2,217)
Deferred income taxes	2	277
Changes in assets and liabilities:		
Receivables from licensees	319	900
Prepaid and other current assets	9,333	(285)
Other assets	(57)	47
Accounts payable	(2,254)	315
Accrued liabilities	(2,447)	(2,601)
Accrued legal settlement	(65,000)	-
Deferred revenue	-	(100)
Net cash provided by (used in) operating activities	(13,152)	26,936
Cash flows from investing activities		
Purchases of investments	(48,313)	-
Maturities of investments	17,881	-
Net cash used in investing activities	(30,432)	-
Cash flows from financing activities		
Repayment of non-recourse notes	(20,311)	(12,621)
Cash dividend paid	(20,966)	(85)
Net excess tax benefit from stock-based compensation	-	2,217
Net cash used in financing activities	(41,277)	(10,489)
Net increase (decrease) in cash and cash equivalents	(84,861)	16,447
Cash and cash equivalents at beginning of the period	211,574	303,227
Cash and cash equivalents at end of the period	\$126,713	\$319,674

See accompanying notes.

Index

PDL BIOPHARMA, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 March 31, 2011
 (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. The financial statements include all adjustments (consisting only of normal recurring adjustments) the management of PDL BioPharma, Inc. (the Company, PDL, we, us or our) believes are necessary for a fair presentation of the periods presented. These interim financial results are not necessarily indicative of results expected for the full fiscal year or for any subsequent interim period.

The accompanying Condensed Consolidated Financial Statements and related financial information should be read in conjunction with the audited Consolidated Financial Statements and the related notes thereto for the year ended December 31, 2010, included in our Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission. The Condensed Consolidated Balance Sheet at December 31, 2010, has been derived from the audited Consolidated Financial Statements at that date.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of PDL and its wholly-owned subsidiaries. All material intercompany balances and transactions are eliminated in consolidation.

Customer Concentration

The following table summarizes revenues from our licensees' products which individually accounted for 10% or more of our total royalty revenues for the three months ended March 31, 2011 and 2010:

Licensees	Product Name	Three Months Ended March 31,			
		2011		2010	
Genentech, Inc. (Genentech)	Avastin®	30	%	27	%
	Herceptin®	34	%	38	%
	Lucentis®	12	%	12	%
Elan Corporation, Plc (Elan)	Tysabri®	13	%	14	%

Foreign Currency Hedging

We hedge certain foreign currency exposures related to our licensees' product sales with foreign currency exchange forward contracts and foreign currency exchange option contracts (collectively, foreign currency exchange contracts). In general, these contracts are intended to offset the underlying foreign currency market risks in our royalty revenues. We do not enter into speculative foreign currency transactions. We have designated the foreign currency exchange contracts as cash flow hedges. At the inception of the hedging relationship and on a quarterly basis, we assess hedge effectiveness. The fair value of the foreign currency exchange contracts is estimated using pricing models using readily observable inputs from actively quoted markets. The aggregate unrealized gain or loss on our foreign currency

exchange contracts, net of estimated taxes, on the effective portion of the hedge is recorded in stockholders' deficit as accumulated other comprehensive income. Gains or losses on cash flow hedges are recognized as royalty revenue in the same period that the hedged transaction, royalty revenue, impacts earnings. The hedge effectiveness is dependent upon the amounts of future royalties and, if future royalties, based on Eurodollar, are lower than forecasted, the amount of ineffectiveness would be reported in our Consolidated Statements of Income.

Index

2. Stock-Based Compensation

Stock-based compensation expense for employees and directors for the three months ended March 31, 2011 and 2010, was as follows:

(In thousands)	Three Months Ended March 31,	
	2011	2010
General and administrative expenses	\$ 50	\$ 188
Income tax effect	(18)	(66)
Stock-based compensation expense included in net income	\$ 32	\$ 122

During the three months ended March 31, 2011, no stock options were exercised, forfeited, or expired unexercised.

3. Net Income per Share

We compute basic net income per share using the weighted-average number of shares of common stock outstanding during the periods presented less the weighted-average number of shares of restricted stock that are subject to repurchase. We compute diluted net income per share using the sum of the weighted-average number of common and common equivalent shares outstanding. Common equivalent shares used in the computation of diluted net income per share result from the assumed exercise of stock options, the issuance of restricted stock and the assumed conversion of our 2.00% Convertible Senior Notes due February 15, 2012 (the 2012 Notes), our 2.875% Convertible Senior Notes due February 15, 2015 (the 2015 Notes), and our 2.75% Convertible Subordinated Notes due August 16, 2023 (the 2023 Notes), on a weighted average basis for the period that the notes were outstanding, including both the effect of adding back interest expense and the inclusion of the underlying shares using the if-converted method. As of March 31, 2011, the conversion rates for the 2012 Notes and the 2015 Notes were 144.474 shares per \$1,000 principal amount of the notes, or a conversion price of approximately \$6.92 per share. The conversion rate for the 2023 Notes as of March 16, 2010, was 177.1594 shares per \$1,000 principal amount of 2023 Notes, or a conversion price of approximately \$5.64 per share. As of September 14, 2010, the 2023 Notes were fully retired or converted.

Following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the three months ended March 31, 2011 and 2010:

(In thousands)	Three Months Ended March 31,	
	2011	2010
Numerator		
Net income	\$44,545	\$26,007
Add back interest expense for convertible notes, net of estimated tax of \$0.7 million and \$0.9 million for the three months ended March 31, 2011 and 2010, respectively, (see Note 10)	1,275	1,635
Income used to compute net income per diluted share	\$45,820	\$27,642
Denominator		
Total weighted-average shares used to compute basic income per share	139,640	119,525
Effect of dilutive stock options	-	9
Restricted stock outstanding	27	89
Assumed conversion of 2012 Notes	19,282	29,256
Assumed conversion of 2015 Notes	26,005	-

Assumed conversion of 2023 Notes	-	35,429
Shares used to compute income per diluted share	184,954	184,308
Net income per basic share	\$0.32	\$0.22
Net income per diluted share	\$0.25	\$0.15

We have excluded 0.3 million and 0.7 million of outstanding stock options from our diluted earnings per share calculations for the three months ended March 31, 2011 and 2010, respectively, because the option exercise prices were greater than the average market prices of our common stock during these periods; therefore, their effect was anti-dilutive.

Index

4. Fair Value Measurements

The fair value of our financial instruments are estimates of the amounts that would be received if we were to sell an asset or we paid to transfer a liability in an orderly transaction between market participants at the measurement date or exit price. We apply a three-level valuation hierarchy for fair value measurements. The categorization of assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. Level 1 inputs to the valuation method use unadjusted quoted market prices in active markets for identical assets and liabilities. Level 2 inputs to the valuation method are other observable inputs, including quoted market prices for similar assets and liabilities, quoted prices for identical and similar assets and liabilities in the markets that are not active, or other inputs that are observable or can be corroborated by observable market data. Level 3 inputs to the valuation method, if any, are unobservable inputs based upon management's best estimate of the inputs that market participants would use in pricing the asset or liability at the measurement date, including assumptions about risk. As of March 31, 2011, and December 31, 2010, we had no Level 3 assets or liabilities. We do not estimate the fair value of our royalty assets for financial statement reporting purposes.

The following table summarizes, for assets and liabilities recorded at fair value, the respective fair value and classification by level of input within the fair value hierarchy defined above:

(In thousands)	March 31, 2011			December 31, 2010		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets:						
Money market funds	\$ 120,702	\$-	\$ 120,702	\$ 203,318	\$-	\$ 203,318
Corporate debt securities	41,543	-	41,543	20,434	-	20,434
Commercial paper	-	8,992	8,992	-	7,998	7,998
U.S. government sponsored agency bonds	10,726	-	10,726	8,725	-	8,725
U.S. treasury securities	5,489	-	5,489	1,997	-	1,997
Foreign currency hedge contracts	-	13,632	13,632	-	17,763	17,763
Total	\$ 178,460	\$ 22,624	\$ 201,084	\$ 234,474	\$ 25,761	\$ 260,235
Liabilities:						
Foreign currency hedge contracts	\$-	\$(20,653)	\$(20,653)	\$-	\$(12,810)	\$(12,810)

The fair value of the foreign currency hedging contracts is estimated based on pricing models using readily observable inputs from actively quoted markets and disclosed on a gross basis in the table above. The fair value of commercial paper is estimated based on observable inputs of the comparable securities.

5. Cash Equivalents and Short-term Investments

Our securities are classified as available-for-sale and are carried at estimated fair value, with unrealized gains and losses, net of estimated taxes, reported in accumulated other comprehensive income in stockholders' deficit. The estimated fair value is based upon quoted market prices for these or similar instruments. The cost of securities sold is based on the specific identification method. To date, we have not experienced credit losses on investments in these instruments and we do not require collateral for our investment activities.

Index

A summary of our available-for-sale securities at March 31, 2011, and December 31, 2010, is presented below:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2011:				
Money market funds	\$120,702	\$-	\$-	\$120,702
Corporate debt securities	41,584	7	(48)	41,543
Commerical paper	8,991	1	-	8,992
U.S. government sponsored agency bonds	10,726	4	(4)	10,726
U.S. treasury securities	5,489	2	(2)	5,489
Total	\$187,492	\$14	\$(54)	\$187,452

Classification on Condensed Consolidated Balance Sheets:

Cash equivalents	\$120,702
Short-term investments	33,685
Long-term investments	33,065
Total	\$187,452

December 31, 2010:

Money market funds	\$203,318	\$-	\$-	\$203,318
Corporate debt securities	20,437	2	(5)	20,434
Commerical paper	7,998	-	-	7,998
U.S. government sponsored agency bonds	8,727	-	(2)	8,725
U.S. treasury securities	1,994	3	-	1,997
Total	\$242,474	\$5	\$(7)	\$242,472

Classification on Condensed Consolidated Balance Sheets:

Cash equivalents	\$205,817
Short-term investments	34,658
Long-term investments	1,997
Total	\$242,472

During the three months ended March 31, 2011, and the year ended December 31, 2010, we did not recognize any gains or losses on sales of available-for-sale securities.

A summary of our portfolio of available-for-sale debt securities by contractual maturity at March 31, 2011, is presented below:

(In thousands)	March 31, 2011	
	Amortized Cost	Fair Value
Less than one year	\$ 33,683	\$ 33,685
Greater than one year but less than five years	33,107	33,065
Total	\$ 66,790	\$ 66,750

As of March 31, 2011, the unrealized loss on short-term investments included in other comprehensive income, net of estimated taxes, was approximately \$26,000. No significant facts or circumstances have arisen to indicate that there

has been any deterioration in the creditworthiness of the issuers of these securities. Based on our review of these securities, we believe we had no other-than-temporary impairments on these securities as of March 31, 2011, because it is more likely than not that we will hold these securities until the recovery of their amortized cost basis.

Index

6. Foreign Currency Hedging

Our licensees operate in foreign countries which exposes us to market risk associated with foreign currency exchange rate fluctuations between the U.S. dollar and other currencies, primarily the Eurodollar. In order to manage the risk related to changes in foreign currency exchange rates, in 2010 we entered into a series of foreign currency exchange contracts covering the quarters in which our licensees' sales occur through December 2012. Our foreign currency exchange contracts used to hedge royalty revenues based on underlying Eurodollar sales are designated as cash flow hedges.

The following table summarizes the notional amounts, foreign currency exchange rates and fair values of our open foreign currency exchange contracts designated as cash flow hedges at March 31, 2011, and December 31, 2010:

Foreign Currency Exchange Forward Contracts			March 31, 2011		December 31, 2010	
Currency	Settlement Price (\$ per Eurodollar)	Type	Notional Amount (In thousands)	Fair Value (In thousands)	Notional Amount (In thousands)	Fair Value (In thousands)
Eurodollar	1.400	Sell Eurodollar	\$ 116,189	\$ (1,113)	\$ 137,179	\$ 6,740
Eurodollar	1.200	Sell Eurodollar	117,941	(19,539)	117,941	(12,810)
Total			\$ 234,130	\$ (20,652)	\$ 255,120	\$ (6,070)

Foreign Currency Exchange Option Contracts			March 31, 2011		December 31, 2010	
Currency	Strike Price (\$ per Eurodollar)	Type	Notional Amount (In thousands)	Fair Value (In thousands)	Notional Amount (In thousands)	Fair Value (In thousands)
Eurodollar	1.510	Purchased call option	\$ 125,318	\$ 683	\$ 147,957	\$ 772
Eurodollar	1.315	Purchased call option	129,244	12,948	129,244	10,251
Total			\$ 254,562	\$ 13,631	\$ 277,201	\$ 11,023

The following table summarizes information about the fair value of our foreign currency exchange contracts on our Condensed Consolidated Balance Sheet as of March 31, 2011, and December 31, 2010:

Cash Flow Hedge	Location	Fair Value (In thousands)	
		March 31, 2011	December 31, 2010
Foreign currency exchange contracts (net)	Foreign currency hedge-current	\$ -	\$ 5,946
Foreign currency exchange contracts (net)	Accrued liabilities	(430)	-
Foreign currency exchange contracts (net)	Other long-term liabilities	(6,591)	(993)
		\$ (7,021)	\$ 4,953

The foreign currency exchange contracts are presented on a net basis on our Condensed Consolidated Balance Sheets as we have entered into a netting arrangement with the counterparty. As of March 31, 2011, the unrealized net loss on the effective component of our foreign currency exchange contracts included in other comprehensive loss, net of

estimated taxes, was \$4.6 million. As of December 31, 2010, the unrealized net gain on the effective component of our foreign currency exchange contracts included in other comprehensive income, net of estimated taxes, was \$3.2 million. There were no ineffective components of our foreign currency exchange contracts during the three months ended March 31, 2011 and 2010. During the three months ended March 31, 2011 and 2010, we recognized \$1.2 million and zero in royalty revenue from foreign currency exchange contracts which settled during the periods, respectively. Approximately \$0.3 million is expected to be reclassified from other comprehensive loss against earnings in the next 12 months.

7. Prepaid and Other Current Assets

Prepaid and other current assets consisted of the following:

(In thousands)	March 31, 2011	December 31, 2010
Non-recourse Notes issuance costs	\$ 2,747	\$ 3,362
2012 Notes issuance costs	531	-
Prepaid taxes	3,376	8,307
Other	1,133	445
Total prepaid and other current assets	\$ 7,787	\$ 12,114

Index

8. Other Assets

Other assets consisted of the following:

(In thousands)	March 31, 2011	December 31, 2010
2012 Notes issuance costs	\$ -	\$ 683
2015 Notes issuance costs	3,972	4,226
Non-recourse Notes issuance costs	1,547	2,397
Other intangible assets, net	50	-
Other	18	-
Total other assets	\$ 5,587	\$ 7,306

9. Accrued Liabilities

Accrued liabilities consisted of the following:

(In thousands)	March 31, 2011	December 31, 2010
Consulting and services	\$ 431	\$ 2,187
Compensation	612	349
Interest	1,833	2,794
Foreign currency hedge	430	-
Other	150	141
Total accrued liabilities	\$ 3,456	\$ 5,471

10. Convertible and Non-Recourse Notes

The following table summarizes our convertible and non-recourse notes activity for the three months ended March 31, 2011, as well as the balances and fair values at March 31, 2011:

(In thousands)	2012 Notes	2015 Notes	Non-recourse Notes	Total
Balance at December 31, 2010	\$ 133,464	\$ 176,964	\$ 204,270	\$ 514,698
Payment	-	-	(20,311)	(20,311)
Discount amortization	-	173	-	173
Balance at March 31, 2011	\$ 133,464	\$ 177,137	\$ 183,959	\$ 494,560
Fair value(1)	\$ 134,038	\$ 182,250	\$ 187,639	\$ 503,927

(1) As of March 31, 2011, the fair value of the remaining payments under our Convertible notes and Non-recourse Notes was estimated based on the trading value of our notes then outstanding.

11. Other Long-Term Liabilities

Other long-term liabilities consisted of the following:

Edgar Filing: PDL BIOPHARMA, INC. - Form 10-Q

	March 31, December 31,	
(In thousands)	2011	2010
Accrued lease liability	\$ 10,700	\$ 10,700
Accrued legal settlement		